

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-7104

To be argued by
Thomas W. Kelly

UNITED STATES COURT OF APPEALS
For the Second Circuit

DAVID E. ROLF,
Plaintiff-Appellant-Cross-Appellee,

-against-

BLYTH, EASTMAN DILLON & CO., INC.
and MICHAEL STOTT,
Defendants-Appellees-Cross-Appellants,

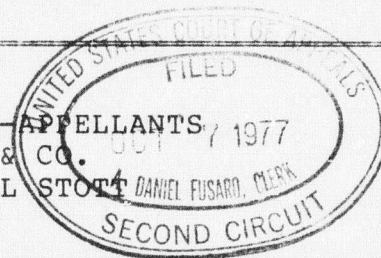
and

AKIYOSHI YAMADA,

Defendant.

Appeal from the United States District Court
for the Southern District of New York

REPLY BRIEF FOR
DEFENDANTS-APPELLEES-CROSS-APPELLANTS
BLYTH EASTMAN DILLON & CO.
INCORPORATED and MICHAEL STOTT



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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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DAVID E. ROLF,	:	
Plaintiff-Appellant-Cross-Appellee,	:	No. 77-7104
-against-	:	
BLYTH, EASTMAN DILLON & CO., INC.	:	Appeal from the
and MICHAEL STOTT,	:	United States
Defendants-Appellees-Cross-Appellants,	:	District Court for
	:	the Southern Dis-
	:	trict of New York
and	:	
AKIYOSHI YAMADA,	:	
	:	
Defendant.	:	

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REPLY BRIEF FOR
DEFENDANTS-APPELLEES-CROSS-APPELLANTS
BLYTH EASTMAN DILLON & CO.
INCORPORATED AND MICHAEL STOTT

Preliminary Statement

We propose in this reply to discuss briefly and simply only the precise issues involved in this appeal responding to plaintiff's brief on those issues and ignoring, so far as we can, questions of secondary or incidental significance.

Two matters are before this Court: (a) plaintiff's appeal from the Trial Court's determination as to damages; and (b) defendants' cross-appeal from the Trial Court's determination of liability. In their main brief, defendants have previously dealt with both of these appeals respectively in Parts One (Points I-VI) and Two (Points VII and VIII).

Defendants' reply brief, in keeping with their main brief, is also divided into two parts.

Part One responds to plaintiff's arguments with regard to the central issue raised by defendants on their cross-appeal, namely, that based on the findings in this case and the governing law, defendants cannot be held liable to plaintiff as aiders and abettors.

Part Two responds to arguments made by plaintiff in further support of his appeal as to the appropriate measure of damages.

Before proceeding further, however, one general observation is required. Plaintiff has submitted an extensive reply brief of some 76 pages, consisting of two parts and eight points which attempt to mirror the divisions of defendants' main brief and contain ostensibly detailed legal and factual arguments in response to the corresponding section of defendants' brief.

At the very outset of his brief, plaintiff sets forth the appropriate standard of appellate review of the Trial Court's findings of fact, a statement of the law which we embrace. However, having stated the standard, plaintiff thereafter proceeds totally to ignore it. The entire reply brief is essentially a trial brief, for it seeks, by reciting great volumes of so-called "facts," to rewrite, modify and otherwise redo the trial court's opinion. In fact, plaintiff's reply brief makes few references to the Trial Court's findings. This persistent

failure of plaintiff to accept the findings of the Trial Court in accordance with the very appellate review standards he espouses can be illustrated by the following examples.

(a) Plaintiff asserts (Pl. Reply Br., p. 5) that Stott was intimately involved in the decision to liquidate Rolf's portfolio, a decision which allegedly Rolf did not approve of (Reply Br. p. 7). The facts are, as the Trial Court held, as follows:

"Both Yamada and Rolf testified that they agreed in April 1969 to make certain changes in the account Yamada stated that Rolf did not agree to liquidate the account. That decision was made by the advisor alone. . . . Plaintiff made no complaint." (JA* 31).

(b) As regards Rolf's alleged investment objective of "safe capital growth," plaintiff also makes the following statements:

"It was Yamada and Stott who 'pre-ordained' the affairs in plaintiff's account and promised him riskless rewards." (Pl. Reply Br., p. 28).

And:

"Stott was crucially involved in influencing the plaintiff's state of mind, and is, thus, responsible for the losses he suffered." (Pltf. Br. p. 29).

The Trial Court's conclusions are clearly to the contrary:

". . . it is clear from the evidence that in May, 1969, Rolf expected Yamada to take substantial risks for capital gains . . ." (JA 29);

*"JA" refers to pages in the Joint Appendix.

". . . it was clear to Yamada that Rolf wanted a very aggressive investment program, and that he was willing to engage in extensive trading in order to 'double his equity' . . . " (JA 28); "Yamada's testimony to the effect that Rolf was interested in special situations, new issues and aggressive trading is confirmed by a letter written by Rolf to Yamada much later." (JA 28).

(c) Finally, plaintiff, in discussing the alleged "low quality" nature of the securities purchased by Yamada for Rolf, states at one point that ". . . almost one half of the securities purchased (19 of 41) were not listed on an exchange;" (Pl. Reply Br., p. 27), yet later makes the incredible statement as regards the securities purchased for him, that "[o]nly Benguet Consolidated was a listed security." (Pl. Reply Br., p. 47).

PART ONE

A.

IN ORDER TO HOLD EITHER DEFENDANT LIABLE AS AN AIDER AND ABETTOR TO THE ADMITTEDLY FRAUDULENT ACTS OF YAMADA, PLAINTIFF MUST PROVE THAT THESE DEFENDANTS HAD ACTUAL KNOWLEDGE OF THE FRAUDULENT CONDUCT, AND SUCH KNOWLEDGE CANNOT BE IMPUTED FROM THE FINDINGS OF THE TRIAL COURT OR THE ARGUMENTS MADE BY PLAINTIFF.

Defendants have previously reviewed in Point VII of their original brief the two critical elements of their cross-appeal, namely:

A. The legal standard for determining aider-abettor liability requires that defendants be proven to

have had actual knowledge of Yamada's fraud;* and

B. Given the Trial Court's finding that defendants lacked knowledge of Yamada's actual fraud, its finding that defendants knew of "junk" stocks and allegedly engaged in "hand-holding" is insufficient to establish liability. (Defts.' Brief, pp. 40-48)

The factual issue presented to this Court on the cross-appeal may properly be formulated as follows:

(1) Did each defendant entertain a reasonable belief that all of the relevant facts were known to Rolf, whether or not, in fact, Rolf knew such facts; and

(2) Did either defendant have any knowledge of, or participate in, the frauds perpetrated by Yamada?

In our main brief we discussed the findings made on these issues by the Trial Court and reached the conclusion that what was found did not reach a level adequate to warrant a legal conclusion that the defendants aided or abetted Yamada in the frauds he committed (Defts.' Brief, p. 35 et seq.).

*The authority establishing this legal requirement is found in very recent decisions of this Court (Abrahamson v. Fleschner, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,889 (2d Cir. 1977), and Hirsch v. du Pont, Fed. Sec. L. Rep. (CCH) ¶ 96,011 (2d Cir. 1977)). Since plaintiff has never discussed either ruling as regards the legal standard for establishing aider and abettor liability, it would appear he accepts the rules of law enumerated in our main brief at pages 35-40 et seq.

The plaintiff, in his Reply Brief, discusses this critical issue and contends that the requisite actual knowledge of the existence of the underlying fraud by Yamada could be imputed to the defendants for the following reasons:

1. Stott knew that Yamada "was purchasing junk" (Pl. Reply Br., p. 47).

2. Stott and Yamada were in daily contact (id., p. 49).

3. Stott "condoned" trading at other brokerage houses even though plaintiff initially requested that "all" transactions be effected through BEDCO (id., p. 45).

4. Yamada's assertion of "control" raised the "specter" of wrongdoing which Stott ignored (id., p. 50).

As to the first of these four points, we have sufficiently discussed that matter in our main brief (pp. 42-45).

As to the second, we need say no more than that daily contact may provide a means of communication but its mere existence cannot warrant a conclusion as to what information was transmitted or what knowledge was acquired.

As to the third, it ignores the critical facts that the accounts were opened by the act and signature of plaintiff (Tr.* 141, 144, 146 and 148), and the opening of these accounts

*"Tr." refers to pages in the Trial Transcript.

by plaintiff was never discussed with Stott or BEDCO* (JA 214, lines 14-18). It is impossible to conclude that defendants knew of the fraud of Yamada by reason of the fact that plaintiff opened accounts with other firms.

The fourth and final fact advanced by plaintiff to establish that his proof adequately showed that defendants had actual knowledge of the fraud of Yamada is said to be that:

"Yamada's assertions to Stott of control raised the specter of wrongdoing which Stott ignored" (Pl. Reply Br., p. 50).

Plaintiff commences his argument with the concession that:

"both Yamada and Stott asserted, and the trial court found, that Yamada had never told Stott of manipulations" (Pl. Reply Br., p. 50).

The findings of the Trial Court are replete with determinations that defendants did not know of the manipulation and control exercised by Yamada. Indeed, a basic finding of the Trial Court is as follows:

"Stott did not know of the direct frauds which Yamada was perpetrating on Rolf" (JA 68).

As to Holobeam and Synchronex, the Court said:

"It is clear that neither Stott nor Rolf knew that these stocks were being used as vehicles to defraud others" (JA 39).

As to seven other stocks that were controlled or manipulated by Yamada, the Court said:

*Blyth Eastman Dillon & Co. Incorporated.

"There is no credible evidence that Stott was aware of the fact that Yamada was using these stocks as vehicles to defraud others" (JA 43).

The basic conclusion made by the Trial Court is found in the following language of the lower court's decision:

"Yamada testified that he often assured Stott that these stocks were 'under control' and that the price would 'go up'. Similarly, Yamada stated that he told Stott there was a 'box,' a term used to encompass not only control over a given security, but also an illegal manipulation. Stott also denied ever hearing the term 'box' used to imply or indicate a manipulation. Faced with this direct conflict between Yamada and Stott's testimony, the Court chooses to discredit the allegations made by the investment adviser" (emphasis added; JA 46).

It is clear that plaintiff is dissatisfied with this finding and seeks to ignore it. Ultimately plaintiff is forced to conclude:

"Thus, even though knowledge is often difficult to prove by direct evidence, the record is replete with direct evidence of Stott's actual knowledge that Yamada was betraying his trust" (Pl. Reply Br., p. 54).

The fatal deficiency in plaintiff's position is that the so-called evidence upon which he relies is exclusively the testimony of a swindler and a liar whose testimony the lower court has refused to believe, and further indeed rejected in favor of the opposite testimony of the defendant Stott.

B.

THERE IS INSUFFICIENT BASIS TO SUPPORT THE FINDING OF LIABILITY ON THE PART OF DEFENDANTS FOR VIOLATION OF THE RULES OF THE NYSE OR THE NASD

In connection with plaintiff's discussion of the NYSE

and NASD rules (Pl. Reply Br., pp. 65-75), we add to our previous detailed discussion (Defts.' Brief p. 48-54) only the comment that plaintiff, as we read it, asserts those rules were violated by reason of the fact that the plaintiff's account was "churned". So far as this appeal is concerned, not only did the lower court expressly find that there was no churning but no appeal is pending on that question (Notices of Appeal and Cross Appeal, JA 79-79A).

PART TWO

DEFENDANTS MAIN BRIEF AT POINTS I TO V
DETAILS THE REASONS WHICH WARRANTED THE
TRIAL COURT'S CONCLUSION NOT TO ALLOW
PLAINTIFF'S CLAIM FOR ANY TRADING LOSSES.

PLAINTIFF'S RESPONSE TO THAT ARGUMENT NOT
ONLY FAILS TO REBUT DEFENDANTS' PRESENTATION,
BUT CONTINUES TO PERPETUATE PLAINTIFF'S
CONFUSION AS TO HIS DAMAGE CLAIM.

In our main brief we have demonstrated that the trading losses realized by plaintiff derived from a varied and disparate group of transactions which we then categorized, separated and discussed. We also demonstrated the reasons which caused the Trial Court to conclude that those specific and varied losses were not shown to have been caused by any wrongful act of BEDCO or Stott.

We do not believe it will be helpful to this Court to repeat or summarize that discussion. We do note that even

plaintiff now concedes, if only for the sake of argument, that the defendants' "grouping is more clear and accurate" (Pl. Reply Br., p. 39).

We are, however, startled at the plaintiff's statement that:

"Even conceding arguendo, that the plaintiff's loss calculations are imprecise, it was defendant's own conduct which rendered them so" (Pl. Reply Br., p. 41).

We will not exhaust the Court with a protracted discussion of all the inaccuracies contained in plaintiff's presentation of his appeal as to the damage issue. Rather, we will discuss but a few revealing illustrations of plaintiff's presentation.

Plaintiff's Reply Brief contains the following statement:

"Loew's Theatre, Inc. is a clear example of defendants' deceptive arithmetic. Defendants assert that the cost of the Loew's stock was \$40,965.18. The figure \$40,965.18 (PX 7) in no way reflects the actual amount of money paid by plaintiff, but constitutes an attempt by plaintiff's bookkeeper to apportion by percentage the relative cost of the shares after they had split. Had defendants taken the time to consult plaintiff's monthly statements, they would have seen that plaintiff's cost was \$90,349.80. (DX A).

Inaccuracies abound in defendants' garbled chart (Defendants' Brief App. I). The cost of Raytheon Co. is listed at \$51,941.50, when the actual cost was \$106,247.89 (DX A)." (Pl. Reply Br., p. 13).

Dealing briefly with this statement, several comments are in order:

First: It is true that defendants' brief did assert that the cost of Loew's stock was \$40,965.18 (Defts.' Br., App. I). The source of that statement is plaintiff's Exhibit 7(E 14) and plaintiff's Exhibit 24 (E 28) in which plaintiff sets forth in the fourth column what he asserted to be the "cost" of 5100 shares of Loew's. In setting forth this figure in our Appendix and recognizing the plaintiff's tendency to blunder with figures our brief carefully stated: "We are aware that these figures taken from plaintiff's schedule (E 14) are, as to these securities . . . incorrect."

Second: Plaintiff asserts further in this paragraph that had defendants taken the time to consult plaintiff's monthly statements we would have discovered that the true cost of the 5100 shares of Loew's stock was \$90,349.80. Wrong again! If one looks at the plaintiff's monthly statements*, the figure of \$90,349.80 represents the initial cost of 1500 shares, which after a 2 1/2-for-1 stock split in January, 1968, a sale of 2,050 shares in March, 1968 for proceeds of \$106,149.34 and an additional 3-for-1 split in December, 1968, leaves the 5100 shares, which we are talking about here. Accordingly, the cost of these 5100 shares on an allocated basis is \$40,958.52.

*See DX A for June 1967, Feb. 1968, March, 1968 and DX A-1 for Jan. 1969.

Third: Plaintiff says the cost of 2000 shares of Raytheon, listed in the Appendix of defendants as \$51,941.50, should really be \$106,247.89. Defendants' brief was premised, as it expressly stated, on plaintiff's figure from his own Exhibit 7 (E 14). We can say that the fact is, and the record proves, that on January 5, 1967, plaintiff purchased 1000 shares* of Raytheon for \$54,306.39 and on June 25, 1968, received an additional 1000 shares as a result of a stock split.

One further example is illustrative. Plaintiff says that by the liquidation of his portfolio he sustained a loss of \$427,000 (Pltfs.' Main Br., p. 18, and Pl. Reply Br., p. 14). The theory used is to take the market value of Rolf's portfolio on April 27, 1969 (DX UU, E 133) less the proceeds realized on the actual sale (Pl. Ex. 7, E 14). These figures, appearing on plaintiff's trial exhibits are:

Market Value (DX UU, E 133)	\$2,238,000
Proceeds on Sale (Pl. Ex. 7, E 14)	- 1,818,925
	<u>\$ 419,075</u>

The best that can be said of plaintiff's computation, which comes to \$427,000, is that it is at least close.

Although the above are but a few examples, the fact remains that throughout this case, defendants have been con-

*DX A for January 1967.

stantly plagued with the presence of contentions and claims by plaintiff which are incorrect mathematically, factually unsupported, or both. We do believe that these errors are not deliberate but simply reflect ineptitude.

One final element of plaintiff's damage claim deserves comment. Plaintiff in his damage calculation asserts as a part of his claim, a loss of \$70,800 realized in his investment in SEIJO a Yamada "trust fund." (Pl. Reply Br. pp. 21-22.) This investment by plaintiff was made under a written agreement entered into between Rolf and Yamada (DX 0; Tr. 149-155; JA 190; JA 459-460). In connection with that agreement Rolf secured the personal note of Yamada (Tr. 58-59). Plaintiff never discussed this private agreement with defendants (Tr. 278), although he did discuss it with his attorney (Tr. 283 and 286-287). He testified:

"Q. What did Mr. Stott tell you about the potential or business of Seijo?

A. He didn't say anything about the potential business of Seijo. He said he thought it was all right and that Yamada will probably work something out so I will recoup my losses.

* * *

Q. Did he tell you anything about Seijo?

A. No." (Tr. 282, line 21 to 283, line 13).

The Trial Court refused to hear testimony regarding the SEIJO transaction. Defendant's counsel sought to show on trial that plaintiff consulted his own attorney on this investment. When

the Court asked for an offer of proof on this issue the following occurred:

"THE COURT: . . . What is your offer of proof?

MR. KELLY: It is evidentiary of the fact in connection with the doctor's investment in Seijo, that he consulted counsel and was otherwise advised in connection with the nature of that investment and therefore with respect to his claim, as respect that investment, Eastman Dillon had nothing to do with it and that claim is not a valid claim." (Tr. 288. Cf. also 289)

After much colloquy (Tr. 289-294) the court refused to receive any of this evidence on SEIJO (Tr. 294-295). We submit that it is inappropriate for plaintiff to renew this claim in this court in face of the Trial Court statement on trial:

"If funds were delivered out [of the BEDCO account] and Dr. Rolf decided to blow the money, take a trip round the world, what is the difference between that and what he did in relation to Seijo" (Tr. 291-92).

CONCLUSION

In our main brief, we discussed the role of the security dealer acting in the presence and under the direction of an investment advisor and concluded that:

"It is impossible to visualize the consequences of establishing as a rule of law that a securities dealer . . . has a duty to oversee and monitor the actions of the person or organization chosen and selected by the customer as the one to make investment decisions" (Main Br., p. 55)

The justification for our concern is emphasized by plaintiff's

reference to an article entitled "Regulating Discretionary Management: Broker-Dealers As Catalysts for Reform" 16 B.C. Ind. & Com. L. Rev. (1975). That article suggests that "[t]here are "several theories under which a continuing duty to monitor and evaluate the advisor might be imposed on the broker dealer". Id., p. 377, n. 127. We do not doubt that such legal theories can be found or devised. We do believe that if plaintiff succeeds in persuading this court to declare a rule of law compelling brokers correctly to monitor and evaluate investment advisors, failing which they may be held accountable for trading losses resulting from the mistaken or wrongful decisions of the investment advisor, it would place a duty upon the securities industry that it is unreasonable to expect can possibly be performed. As this Court has wisely said it is not the function of Rule 10b-5 "to establish a scheme of investor's insurance" (List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1965), 463).

Dated: New York, New York
October 7, 1977

Respectfully submitted,

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Defendants-Appellees-Appellant :

AFFIDAVIT OF
SERVICE BY
MAIL

-----x
STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

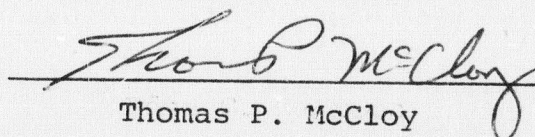
THOMAS P. McCLOY being duly sworn, says: I am em-
ployed in the office of Breed, Abbott & Morgan, 1 Chase Manhattan
Plaza, New York, New York 10005, attorneys for Blyth Eastman Dillon
and Michael Stott in the above entitled action.

On October 7, 19 77, I served the annexed
REPLY BRIEF

3 true copies
by depositing ~~a true copy~~ thereof in a sealed, postpaid envelope
at the post office box maintained at 1 Chase Manhattan Plaza, New
York, N.Y. 10005, addressed to the following:
Silverman & Harnes, Esqs., 75 Rockefeller Plaza, New York, N. Y.
10019

Sworn to before me this
7th day of October, 19 77

EDNA G. WATKINS
NOTARY PUBLIC
No. 82-9549550
Qualified in Kings County
Certificate Filed in New York County
Commission Expires March 30, 1978


Thomas P. McCloy